

Lifetime Gifting

Guidance notes

Introduction to Lifetime Gifting

There are a variety of reasons why clients may want to give money or assets away. Common examples include assisting a son or daughter with their first house purchase, or donating towards the cost of a family wedding. With careful planning, it may also be possible to reduce the value of an individual's estate through lifetime gifting, and therefore minimise the eventual inheritance tax ('IHT') liability. Lifetime gifting can also be a tax efficient method of donating to a favoured charity or political party.

Gifts exempt from IHT

There are a number of IHT exemptions that can be taken advantage of when making gifts, and some of the more commonly employed methods are outlined below:

1. Normal gifts made on birthdays or at Christmas are exempt from IHT if made out of income. Wedding or civil partnership gifts of up to £1,000 are also exempt from IHT, and this increases to £2,500 if the recipient is a grandchild or to £5,000 for a child.
2. Gifts between UK domiciled spouses or civil partners are free of IHT without limit. Gifts can be made to a non-UK domiciled spouse or civil partner but there is a limit set on the exempt amount equal to the nil rate band ('NRB'), currently £325,000.
3. Gifts to charities or political parties are free of IHT.

4. No IHT is due on gifts that go towards helping ex-spouses and partners with living costs, or gifts to relatives who are dependent because of illness, old age or disability, or who are children under the age of 18.
5. An annual IHT exemption is applicable to lifetime gifts. This is currently limited to £3,000 per tax year, although it is possible to carry over this exemption from the previous tax year if it was unused.
6. Gifts from surplus income can qualify for exemption from IHT. Such gifts need to have been paid from income rather than capital, have no detrimental impact upon the donor's standard of living, and be part of normal expenditure.

When planning to use this exemption it is important to ensure that payments are indeed made from income, and to bear in mind that withdrawals from an investment bond and the commencement lump sum from a pension are not classed as income. If the client has to resort to using capital to maintain their standard of living as a result of the gifts from income, then the gifts will fail to qualify for the exemption. To meet the normal expenditure requirement, there should be evidence of a series of payments or at least the intention to have made regular gifts.

Potentially exempt transfers and chargeable lifetime transfers

If a gift is not exempt from IHT then it is likely to be either a potentially exempt transfer (PET) or a chargeable lifetime transfer (CLT). A gift above the annual limits and outside of the exemptions mentioned above would be a PET if the amount is gifted to a specific named individual, whether as a direct transfer or as a gift to a bare trust.

Making a PET starts a seven year clock. If the donor survives for this period, the gift becomes exempt. If the donor dies within the seven years, the PET forms part of their estate and there may be an IHT liability. If the donor dies between three and seven years from the date of the PET, any IHT liability will be charged at a rate lower than the standard 40% (based on a sliding scale). This is known as IHT taper relief, and the rates are set out in the table below. There is no upper limit on the value of a PET above which lifetime IHT is applicable (as there is for a CLT).

Years between gift and death	Percentage of standard IHT rate applied	Equivalent rate based on IHT at 40%
Less than 3	100%	40%
3 – 4	80%	32%
4 – 5	60%	24%
5 – 6	40%	16%
6 - 7	20%	8%

Gifts to most modern discretionary trusts are treated as CLTs. Like a PET, a CLT may fall outside an individual's estate if they survive for seven years after having made the gift (although it could take longer, as covered in the next paragraph). However, unlike a PET, with a CLT there is scope for an immediate lifetime IHT charge to arise. This occurs when the amount of the CLT, when added to other CLTs within the previous seven years, exceeds the NRB (currently £325,000). The excess attracts a lifetime IHT charge.

If the trust pays the IHT liability, the rate at which the lifetime IHT is applied is half of the death rate for IHT (40% / 2 = 20%). If the Settlor pays, then the amount of the liability increases as there is an increased loss to the Settlor's estate. See below for an example of the IHT calculation:

- An individual makes a gift of £400,000 to a discretionary trust
- They have already used their annual IHT exemption and have made no CLTs previously

- The amount above the NRB = £400,000 - £325,000 = £75,000
- If the Trustees pay, IHT = £75,000 x 20% = £15,000
- If the Settlor pays then the tax figure is grossed up, IHT = £15,000 x 1.25 = £18,750.

We have mentioned the seven year clock but in some circumstances it is necessary to take account of gifts having been made up to 14 years ago. If a donor dies within seven years of having made a PET, the PET is deemed to have failed. The value of the PET is then included in the value of the deceased's estate and any CLTs made within the seven years prior to the failed PET also have to be taken into account. For example, a CLT made in 2005 would have to be included within the estate of an individual who died in 2017, having also made a PET in 2011.

Charitable gifts

Donations made by individuals to charities, political parties and/or community amateur sports clubs ('CASCs') are tax free.

If donations are made through gift aid, the charities and CASCs will be able to claim back 25%. If the donor pays income tax above the 20% basic rate, they will be able to claim back the difference through their self-assessment tax return.

Some companies will provide Payroll Giving Schemes. Donations made through such schemes will be deducted from an individual's salary before income tax is taken off.

It is also possible to donate land, property or shares to a charity without paying either capital gains or income tax, even if they are sold at less than market value.

Keeping a record of gifts

When making gifts, either as lump sums or out of excess income to individuals or charities, it is important that the donor keeps thorough records of the amounts and dates of the gifts.

These records will be essential, particularly on death of the donor, in order to provide accurate information to the individual's executors and HMRC so that the correct amount of tax is applied to the estate.

Transact has provided a simple gift log tool which advisers and their clients can use to keep ongoing records. This tool allows for one off gifts to be recorded and for excess income to be calculated prior to it being gifted. The gift log tool can be found on Transact Online under Information → Trust Documents.

Trust service providers

This guide is intended to provide basic guidance on lifetime gifting. As trusts are an integral part of gifting and estate planning, Transact has formed links with other providers who can assist as and when required.

These providers include banks who can provide trust bank accounts, as well as trust writing, corporate trustee and trust accountancy services. You may already have relationships with existing providers, however if required, details of these providers can be found on the Transact website [here](#).

Notes

Taxation laws and regulations are subject to change over time and such changes cannot be predicted. The statements in this guide are based on our understanding of the current law and practice (as at October 2019).

These guidance notes have been prepared as a basic introduction to lifetime gifting. These notes are not intended to be a recommendation on any aspect of lifetime gifting and should not be taken as a substitute for professional advice. Individuals considering lifetime gifting must take appropriate tax, legal and investment advice on their circumstances and requirements from professional tax and trust advisers. Integrated Financial Arrangements Ltd, the operator of Transact, does not accept any liability or responsibility for actions taken in reliance on these notes.



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